

# ANALYSIS OF ORIGINAL BILL

## Franchise Tax Board

Author: Speier Analyst: LuAnna Hass Bill Number: SB 1477  
Related Bills: See Legislative History Telephone: 845-7478 Introduced Date: February 19, 2002  
Attorney: Patrick Kusiak Sponsor:

**SUBJECT:** FTB Collection Of California Student Aid Commission Outstanding Accounts Receivable

### SUMMARY

This bill would require:

- the California Student Aid Commission (CSAC) to contract with the Franchise Tax Board (FTB) to collect CSAC's outstanding student loan delinquencies, and
- licensed health care professionals that have delinquent student loans to have their license suspended until the delinquency is cleared.

This analysis will not address the provision regarding licensed health care professionals since it does not specifically require FTB to administer the provision, and it does not impact the department or state income tax revenue.

### PURPOSE OF THE BILL

It appears the purpose of this bill is to increase the collection of delinquent student loans by using the resources available to FTB.

### EFFECTIVE/OPERATIVE DATE

This bill would be effective and operative January 1, 2003. At this time, the department would begin negotiating an agreement with CSAC, which, if successful, could take several months to complete (see "Economic Impact" below).

### POSITION

Pending.

#### Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

#### Department Director

#### Date

Gerald H. Goldberg

03/29/02

## **ANALYSIS**

### FEDERAL/STATE LAW

Under current Personal Income Tax Law (PIT), a tax debt is due and payable, becomes an enforceable tax lien, and becomes subject to collection once the self-assessed tax becomes a record on FTB's accounts receivable file. The same is true in the case of a deficiency assessment once the taxpayer has had an opportunity for required hearings and exhausted administrative remedies. If the department does not receive payment in full, the department notifies the taxpayer that collection action may commence, including wage garnishments, bank levies, and the recordation of tax liens. Under state law, FTB is not required to obtain judicial authorization prior to taking enforcement action or issuing warrants to seize and sell (levy) the taxpayer's assets. If the taxpayer is experiencing financial hardship, the taxpayer may make installment payments or defer payment.

State law authorizes FTB to administer several non-tax programs, including but not limited to, child support collections and delinquent vehicle license fee collections. To collect on these non-tax debts, the department is authorized to use the remedies and information sources available for collecting PIT debts. In addition, the department may use any source and remedy available to the agency referring the debt for collection.

### THIS BILL

This bill would require CSAC to enter into an agreement with FTB to collect all or part of CSAC's delinquent account receivables. The agreement must include the criteria, standards, and procedures for referring delinquencies to FTB. In addition the agreement must include language addressing the following:

- Delinquencies referred by CSAC are delinquent as defined by CSAC.
- In the event the debtor notifies the FTB of a disagreement with the amount due, FTB may refer the debtor or account back to CSAC and/or rescind collection action. To re-refer a delinquency for collection, CSAC would have to reduce the debt to a judgment or an enforceable lien, if necessary, to meet due process requirements.
- FTB's costs to administer, maintain, and support this CSAC collection program would be funded from the amounts it collects under this program, not to exceed 15% of the collection.
- The debtor may be allowed to enter into a voluntary installment payment agreement.

CSAC would be required to develop criteria and policy for determining when an account is delinquent. The criteria and policy may include a minimum dollar threshold for referral to FTB. However, in any event, a delinquency could not be referred to FTB for collection action until:

- CSAC determines that the delinquency is due and payable,
- notice of the amount due and payable was sent to the debtor at the last known address maintained by CSAC,
- the debtor has exhausted all required administrative hearings and a judicial proceeding is not pending, and
- the account has been referred to a private collection agency which has been unsuccessful in collecting the account for a nine-month period.

Further, this bill would:

- Specify that the development and implementation costs to support the collection of student loan delinquencies will be addressed in a separate agreement between FTB and CSAC.
- Allow FTB to collect on the delinquent accounts using all remedies and information sources available for collecting PIT delinquencies, as well as any information sources and remedies available to CSAC.
- Require FTB to provide a notice to the debtor that payment of their delinquency in full will prevent further collection action.
- Provide that the activities that would be required by FTB to implement and administer this bill must not interfere with the primary mission of FTB to administer income and corporation taxes.
- Require interest on CSAC delinquencies to be computed by CSAC, as permitted by law.
- Specifically provide that the amounts collected for CSAC would not be construed to be tax payments.
- Provide that although the debts would be collected as though they are income taxes, the debts would not be construed to be taxes for purposes of a debtor's bankruptcy proceeding.
- Allow FTB, CSAC, and the Controller to adopt regulations to implement this program.

Upon concurrence of the Controller, FTB's collections of CSAC delinquencies would be deposited into an existing account or fund as provided by the CSAC/FTB interagency agreement.

### IMPLEMENTATION CONSIDERATIONS

The department's ability to implement this bill is unknown until the department can develop an implementation plan, but this bill is anticipated to impact the department's programs and operations significantly. Specifically, the department would need to develop a new automated collection system. Once the system is established, the department would have a better understanding of the resources that would be needed to reestablish the program.

This bill would require CSAC and FTB to develop an agreement to require CSAC to reimburse FTB for the costs to develop and implement a program to collect on student loan delinquencies. However, it does not provide for an appropriation for CSAC to fund FTB's development and implementation costs, which could be significant. Without an appropriation, the implementation of this bill may be delayed. In addition, FTB's costs to administer, maintain, and support this CSAC collection program would be funded from the amounts it collects under this program, up to 15% of the amount collected. Until an implementation plan is developed and departmental cost projections are estimated, staff is uncertain that 15% would sufficiently cover costs.

This bill would allow private debt collectors to attempt collection of the delinquent accounts for at least nine months prior to the account being referred to FTB. A review of the department's accounts that were referred during the Student Loan Collections pilot program found that FTB was unable to realize its full collection potential because the referred accounts had been aged by the nine months that the accounts were with private debt collectors. In addition, approximately 40% of the delinquent accounts referred by CSAC were accounts where the debtor attended a trade school, such as a trucking school or beauty college. The department experienced delayed collections since these debtors had a higher unemployment rate or a lower income.

## **LEGISLATIVE HISTORY**

AB 255 (Speier, Stats. 1996, Ch. 1001) required CSAC to contract with FTB to collect CSAC's outstanding student loan delinquencies. This provision expired January 1, 2002.

AB 2004 (R. Wright, 1997/1998) would have expanded the notice and due process requirements for CSAC delinquencies referred to FTB. According to Governor Wilson's veto message, this bill would have expanded the rights of severely delinquent debtors beyond the rights of those debtors that attempt to pay their debts. Further, the excessive administrative process would have diminished the state's ability to collect on delinquent student loan accounts.

AB 1044 (R. Wright, 1999/2000) was generally the same as AB 2004 (R. Wright, 1997/1998) and failed passage in the Senate.

## **PROGRAM BACKGROUND**

The department uses an automated tax collection system to send notices of delinquency to taxpayers and to garnish wages and levy bank accounts. This automated system searches through more than 220 million income records (including wage, dividend, and interest information) to locate an individual's assets. Once assets are located, the system can issue levies on bank accounts, wages, commissions, rents, and other miscellaneous sources of income.

In order to utilize these same collection methods for other types of debts owed to the state, the Legislature passed AB 255 (Speier, Stats. 1996, Ch. 1001), in August 1996. Generally, AB 255 contained the same provisions as this bill regarding student loan collections, except that AB 255 instituted the collections program as a pilot program that was scheduled to sunset January 1, 2002.

In accordance with the legislation, FTB and CSAC entered into an interagency agreement regarding the referral of student loan accounts for collection by FTB. The contract covered the period of April 1, 1997, through March 31, 2000. Upon expiration of the contract, negotiations for a new and more detailed contract for the remainder of the pilot program were not pursued by CSAC.

## **OTHER STATES' INFORMATION**

A review of *Florida*, *Illinois*, *Massachusetts*, *Michigan*, *Minnesota*, and *New York* laws found that all these states have some type of agency that administers financial aid services. The *New York* and *Michigan* agencies specify that defaulted student loans may be turned over to private collection agencies by either the lender or the agency. The information regarding defaulted student loans for the remaining states was inconclusive.

The laws of these states were reviewed because their tax laws are similar to California's income tax laws.

## **FISCAL IMPACT**

Department costs cannot be determined until an implementation plan has been adopted, but are anticipated to be significant.

## **ECONOMIC IMPACT**

### Collections Estimate

This analysis is based on:

- FTB's experience with the Student Loan Collections pilot program, created by AB 255 (Stats. 1996, Ch. 1001), and
- the assumption that accounts referred by CSAC would be similar to those referred to FTB for collections in the previous Student Loan Collections pilot program and contract agreement which expired on March 31, 2000.

This bill would require the department to collect on delinquent student loan accounts. The money collected would eventually be deposited into a student loan fund that would not directly relate to the General Fund. For fiscal year 2002/2003, collections are estimated to be minor due to a projected delay in contract negotiations of approximately six months. For fiscal year 2003/2004 collections are estimated to be \$15 million. To the extent implementation and contract negotiations are delayed for more than six months, the collection estimate for fiscal year 2003/2004 would be further reduced. The timing of collections is integral to this estimate because:

- accounts that are referred in the later part of a fiscal year typically would not result in collections until the next fiscal year, and
- during a given fiscal year, multiple, ongoing payments would be coming in as a result of wage levies issued or payment arrangements made on older referrals from prior fiscal years. These payments would be in addition to the single payments attributable to new collection actions.

A further reduction, which could be significant, may result if CSAC is currently successful in garnishing wages.

## **ARGUMENTS/POLICY CONSIDERATIONS**

As discussed under "Program Background," the department's automated collection system searches through income records to locate and issue levies on an individual's assets, such as bank accounts and wages. Since this bill would allow student loan delinquencies to be collected as if they were income tax debts, the levy rate would be 25% of the debtor's aggregate disposable earnings. Student loan delinquencies are subject to federal law, which has a levy rate of 10%. It is unclear whether the federal levy provisions of 10% preempt FTB's California levy authority of 25%. Therefore, FTB would administratively limit its wage levies on student loan accounts to 10%, which would result in delayed collections.

As discussed above under "Program Background" negotiations for a new and more detailed contract for the remainder of the original student loan collection pilot program were not pursued by CSAC. During the negotiations, FTB and CSAC were in agreement that a more detailed contract would have been appropriate. This bill would require a new agreement between CSAC and FTB. It is anticipated that the parties would again pursue a more detailed contract. Specifically, the liability for federal due diligence would need to be clearly and fully addressed in any contract agreement between CSAC and FTB. In addition, the confidentiality of the department's systems and operations in relation to compliance with federal due diligence would need to be addressed in the agreement.

Historically, concern has arisen when the department contracts for a percentage of collection to cover costs because the possibility exists that the percentage may not cover the costs of the program in any given year and monies from the General Fund may be needed to cover any difference.

Generally, the department's collection programs use effective collection techniques in order to generate maximum revenue to fund the state government. This bill would require a state agency to collect money that does not benefit the General Fund. It is unclear if a state agency should be the collector of last resort for accounts that do not have a direct impact on the state government.

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